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UNCLAS SECTION 01 OF 02 GUANGZHOU 000498

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SUBJECT: Unraveling? - Guangdong Apparel Exports to the U.S. Drop Sharply

REF: A. Guangzhou 0414; B. Guangzhou 0406

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1. (U) Summary: The apparel export powerhouse that is Guangdong has become a little less powerful. Global apparel exports dropped 31.3% during the first half of the year, and exports to the United States fell 27.3%. Local firms blame demanding U.S. buyers, renminbi (RMB) appreciation, increased labor costs brought on in part by the new Labor Contract Law and pressure on the industry to relocate out of the Pearl River Delta (PRD). Rapid development of the industry in other parts of China and abroad also threatens Guangdong's comparative advantage. End summary.

2. (SBU) The first half of 2008 saw a dramatic drop in Guangdong apparel exports to the United States. According to the Guangdong Statistics Bureau the province's overall garment exports fell by 31.3%, and exports to the United States decreased by 27.3%. Guangdong is one of China's top five apparel manufacturing provinces.

U.S. Demands High Quality, Lower Prices

3. (SBU) Local contacts in the industry have placed some of the blame on demanding U.S. buyers. Ling Fangcai, chairman of the Guangdong Textile Import and Export Company, told us that the two main challenges to doing business with U.S. buyers are the demands for low prices and complying with U.S. quality standards. Li Lichang, general manager of the Foshan Xinguang Knitting Company, complained that U.S. buyers are increasingly enforcing the 'Wal-mart theory' on imports, requiring higher quality goods, and often higher volumes, at lower costs. Li explained that she had had several disputes with U.S. companies regarding quality control and recently cancelled a major deal with sneaker giant Puma USA because of cost and quality demands. One factory owner also said the increasing incorporation of corporate social responsibility (CSR) standards by U.S. companies is in conflict with some local manufacturing practices.

4. (SBU) Eric Lo, a factory owner in Guangdong's Foshan city, told us that Europe and Japan are better clients. He pointed out that because Guangdong is able to produce high quality products quicker than many domestic and international competitors, some international buyers are willing to absorb the region's higher production prices. He said that European and Japanese buyers place a greater emphasis on quality, and are willing to pay for it. He believes the U.S. market is no longer attractive to Guangdong apparel manufacturers. Foshan Xinguang Knitting Company General Manager Li pointed out that although she had cancelled a deal with Puma USA, the company is still supplying Puma Japan and Puma Europe.

The Dollar Falling, Labor Costs Rising

5. (U) Factory owners also complain that the average 6% appreciation in the RMB over the past few months has exacerbated price demands from U.S. buyers. As one apparel maker explained, the impact on factory profits depends on the terms of the contract with the U.S. buyer -- the longer the delivery and payment terms, the lower the profits.

6. (U) Apparel factory owners repeated complaints we've heard frequently from labor-intensive industries in the PRD that the new Labor Contract Law is driving up labor costs (ref A). In our discussions with factory owners, they acknowledged that the new law is intended to balance economic growth with increased standards of living. However, one owner argued that even though the law might benefit people in the future, it was hurting enterprises today. He stressed that the changes forced by the law were too rapid.

Factories Relocating

7. (U) Guangdong's "double transfer" policy aimed at moving labor-intensive factories out of the PRD (ref B) also poses a challenge to Guangdong's apparel industry. The municipal government of Foshan, one of Guangdong's top apparel producers, is forcing four types of enterprises to relocate, all of which could include apparel

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proactively relocating to the government's target destinations such as Qingyuan and Heyuan; others are simply relocating to suburban areas of Foshan. One manager argued that relocating apparel factories did not make sense, and doubted that the "double-transfer" policy would be effectively implemented anytime soon. He said garment manufacturers relied on a sophisticated supply chain that would have to be relocated as well. He believes this is not feasible.

Increasing Competition: At Home and Abroad

19. (SBU) Zhu Zejiang, General Manager of Foshan Sanden Industries Company, told us that stiff competition both home and abroad is hurting sales for companies in Guangdong. Domestically, Guangdong is competing with factories relocating to and springing up elsewhere in China. In the first half of 2008, Zhejiang, Jiangsu, Shandong provinces and Shanghai experienced a 20% increase in apparel exports, according to local newspaper, Nanfang Daily. These factories have cheaper operating costs due to, among other reasons, less governmental pressure and oversight. Zhu claims the apparel industry supply chain is weaker in those areas, but fears they will develop rapidly and soon gain a comparative advantage over Guangdong. Factory owners commented that they are seeing more competition from South and Southeast Asian countries, including Cambodia, Vietnam, and Bangladesh, because of cheaper labor costs there. Some of the foreign competition may be coming from factories previously based in Guangdong.

10. (U) In the long-run, some factory owners believe that increasing costs and factory relocations won't diminish Guangdong's role in the global textile and apparel industry. However, one manager suggested that Guangdong may have to develop new niches such as supply chain management, rather than manufacturing.

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